

LE's Initial Forecast for 2009 Predicts that 1,354 Hotels with 159,368 Rooms Will Open in the U.S.
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Private Equity Makes a Big Splash in the Lodging Industry

Lodging Econometrics (LE), the Global Authority for Hotel Real Estate, in its mid-year report to the Lodging Industry has just released the highly anticipated Forecast for New Hotel Openings in 2009. LE predicts that 1,354 new hotels having 159,368 rooms will open in '09: a gross growth rate of 3.3% for that year, likely to net to slightly less than 3% after accounting for hotel closings and other removals from the industry's Census.

After reviewing over 4,600 projects in the total current Pipeline directly with developers and re-verifying Construction Start and Completion Dates with Brand managers, LE made just minor adjustments to its earlier Forecast for '07. Totals are now expected at 1,042 hotels / 100,924 rooms, representing a 2.2% growth rate for '07; and 1,200 hotels / 136,692 rooms with a 2.9% growth rate for '08.

LE's president, Patrick Ford, said, 'The Pipeline has grown at an accelerated pace since 2005 and is just now beginning to unfold for the next phase of the cycle. New Openings in '07 and '08 should be comfortably absorbed now that the economy has again sparked forward, but '09 will begin to show wider supply/demand imbalances that will continue into the early years of the next decade.'

Construction Pipeline at 2Q07 – Forecast for New Openings			
	Hotels	Guestrooms	Supply Increase (%)
'09 (E)	1,554	159,368	3.3 (Gross)
'08 (E)	1,200	136,692	2.9 (Gross)
'07 (E)	1,042	100,924	2.2 (Gross)
'06 (A)	734	78,871	1.7
'05 (A)	657	70,808	1.6
'04 (A)	555	58,420	1.3

Source: Lodging Econometrics Portsmouth, NH, the Global Authority for Hotel Real Estate

Ford continued, 'Record breaking industry-wide profitability is expected into '09 - but it will be mostly driven by room rates. Barring any exogenous economic or political event, this cycle peak should be a real sweet spot for the industry.'

All Pipeline Metrics are at a Cyclical High

'Now that a near-term recession is no longer likely, developers have turned exuberant once again and are moving at a quick pace. For the last two quarters the Pipeline has grown at an accelerated pace and stands at a cyclical high of 4,636 projects / 611,341 rooms. The Pipeline grew by 643 projects / 81,403 rooms in the first half of '07 alone, a 15% increase,' said Ford.

Project migration up the Pipeline has accelerated now that economic visibility is clearer. Projects Under Construction and those Scheduled to Start in the Next 12 Months are also at cyclical highs.

Pipeline at 2Q07 by Construction Stage		
	Projects	Rooms
Under Construction	1,335	193,839
Scheduled Starts, Next 12 Months	2,228	271,591
Early Planning	1,073	145,911
Total Construction Pipeline	4,636	611,341

Source: Lodging Econometrics Portsmouth, NH, the Global Authority for Hotel Real Estate

Construction Starts for the quarter were 340 projects / 48,837 rooms, a notable cyclical high. It's a 41% quarter-over-quarter increase, accelerating year-over-year trends up to 36%.

New Project Announcements into the Pipeline ballooned to 756 projects / 93,777 rooms for the quarter, by far the highest total in this cycle.

The mood is exuberant and the pace of development and franchising has quickened. Developers feel that the Fed is on the sidelines for a while and that now is the time to act. Despite recent increases in long-term interest rates and some tightening in loan covenants this full-employment economy is being seen as a golden time for lodging development.

The Development Mood is Exuberant Internationally Also

Economic growth and lodging operating yields are robust and lending conditions are attractive in many developing countries worldwide. Growth in many emerging economies in Eastern Europe and Asia could even be termed explosive. The four big public companies - Marriott, Hilton, Starwood and InterContinental - sense great opportunity for brand distribution and for growing management and franchise fee income. They are geared up to expand. They have executive teams in place and their Global Development Pipelines are expanding rapidly.

Guestroom Demand is the Metric to Watch

During the period of July '06 through early '07, economic growth turned downward causing concern that the economy might slip into recession. Demand growth was so weak that it could not cover the scant new supply coming online. Fortunately, the economy rebounded and demand has improved slightly.

'The question moving forward,' said Ford, 'is whether there will be sufficient demand growth to help offset the new supply that is surely coming. If there is an early disconnect, there could be significant supply/demand imbalances in many markets, putting pressure on rates that in turn could impact projected profitability.

Imbalances are already visible in some resort locations. When the Pipeline begins to unfold this fall, first with smaller mid-market properties, supply/demand imbalances will initially surface at highway and outer suburban locations.

Later, in '08, imbalances are likely to appear in the inner suburbs; with the larger, higher-priced, select-service type of hotels. '08 will begin the influx of new mega casino projects, particularly in Las Vegas.

Finally, in '09 and into the next decade, there will be a number of larger mixed-use upper upscale and luxury properties coming online in urban centers.

Caution is the Watch Word for Developers

From day of announcement until opening day, the average 125 room mid market hotel spends 27 months in the Pipeline while the average 150 room select service or extended stay hotel spends 33 months. That suggests that new projects announced this fall will most likely open in 2010 or 2011, the two years projected to have the largest number of New Openings this cycle.

That means developers should be well informed about market conditions and proceed with caution. Go/no go investment and development decisions should only be made after a thorough investigation of planned Pipeline projects in that particular market. A forecast for New Openings three years forward should be studied to determine if there's room for an additional hotel. An assessment of New Openings for the past two years should also be made to determine if an absorption problem already exists.

Development conditions seem so favorable, but it's important to remember that this development cycle is approaching its peak. A meticulous review of Pipeline research seems critical to informed decision making.

Private Equity Seeks Lodging Investments

Since May '06, six publicly traded Lodging REITS have gone private. 345 Hotels / 49,014 rooms have transferred at a value of \$6.7 Billion. Three more REITS, with 172 hotels / 27,626 rooms, are set to close before year end.

The largest private equity groups are now turning their attention to the Industry's most prominent publicly traded hotels companies. Blackstone's proposed acquisition of Hilton is a capstone transaction valued at \$26 Billion, estimated to be \$20 Billion in equity and \$6 Billion in debt. It represents a whopping 40% premium for Hilton's shareholders as valued by Hilton's closing price the day before the announcement.

The transaction is significant because it has more of a long term strategic feel to it. Much of Hilton's potential will not be available until well into the next decade.

Little information is available during the quiet period but assuming the structure is typical for Blackstone - lots of short term borrowing with a minimum of Blackstone's own cash - the deal may follow the footprint established with Sam Zell's office portfolio.

That might suggest a near term sale of some or all of Hilton's eight trophy assets in New York, Hawaii, San Francisco, Chicago, Washington and New Orleans. Four of those assets are in New York and Hawaii and are said to represent 17% of Hilton's total profits.

Blackstone has a number of options available - including a possible Hilton REIT or Master Limited Partnership - to retain control and the long term stream of franchise and management fees. Assuming lender covenants permit and as long as the debt and IPO windows remain open, there's an advantage to not acting too quickly. Trophy asset values are expected to escalate further, well into the next decade.

After that, it's really a 'futures' story for Blackstone. Hilton has 691 publicly announced New Construction and Reflagging projects with 85,185 rooms in their domestic Pipeline. It's equivalent to 21% of their existing Census and represents significant future franchise and management income. And, their pipeline is still growing. It's not yet at its cyclical peak.

Hilton's international potential is even more long term. The recent acquisition of Hilton International, allowed Hilton to become a global company and develop its whole family of brands outside North America for the first time. Hilton is behind other major companies and is really just getting started. The international potential for these world class brands is enormous, but years down the road.

Other synergies available to Blackstone are the possible rebranding of its LXR world class resorts and other high end hotels in their current portfolio. Perhaps there might be a different direction for La Quinta as well.

There are other obvious efficiencies to sort out: duplicative management and development teams, the combining of technology, operating, marketing, sales and development systems etc...

Another plus. Blackstone has other real estate investment initiatives underway internationally, particularly in Europe, China, India and Russia. They now have a stable of high profile international brands available to work into their planning. This again suggests long term investment and an extended holding period.

If Blackstone is thinking ahead to the next cycle, Hilton seems the ideal vehicle to morph Blackstone's mission into asset managers and committed long term holders of operating companies with world class brands.

Lodging Econometrics (LE) of Portsmouth, NH is the global authority for hotel real estate. LE conducts Supply Side research for all markets, developers and brands and companies in: U.S.; Canada; Mexico, Central America and the Caribbean; Europe; Asia; Middle East; South America; and Africa.

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